

CONFIDENTIAL

February 14, 1997

FEB 14 1997

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of)	
)	
Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review)	CC Docket No. 94-1
for Local Exchange Carriers)	
)	
Transport Rate Structure and Pricing)	CC Docket No. 91-213

REPLY COMMENTS OF
SOUTHWESTERN BELL TELEPHONE COMPANY

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Table of Contents
Reply Comments of Southwestern Bell Telephone Company
CC Docket No. 96-262

<u>Subject</u>	<u>Page</u>
Summary	i
I. THERE IS NO “FREE LUNCH” IN ACCESS REFORM.	2
A. MANY PARTIES HAVE FALLEN INTO PREDICTABLE POSITIONS.	3
B. COMPETITIVE MARKETS OPERATE UNDER CERTAIN PRINCIPLES ...	4
II. SWBT’S PLAN FOR ACCESS CHARGE REFORM FITS THE BILL.	5
A. SWBT’S PLAN SETTLES THE DEBATE OVER PRESCRIPTIVE VS. MARKET- BASED.	6
1. SWBT’s Plan Contains Proper Aspects of a Prescriptive Approach.	6
2. SWBT’s Plan Contains Proper Aspects of a Market-Based Approach. ...	7
B. COSTS SHOULD BE BORNE BY THE COST CAUSER.	8
1. End User Costs Should Not Be Recovered From IXC’s.	8
2. TIC Costs Are Legitimate.	11
3. Switching Costs	13
4. Transport Costs	14
5. ISPs Must Pay The Costs They Cause.	15
C. SWBT’S PLAN PROVIDES PROPER ACCESS CHARGE PRICING FLEXIBILITY.	17
III. ACCESS STRUCTURE MUST PROVIDE THE OPPORTUNITY FOR INCUMBENT LECS TO RECOVER ACTUAL INTERSTATE COSTS.	19
A. REGULATORS HAVE PREVIOUSLY DETERMINED THAT THE INCUMBENT LECs’ ACTUAL COSTS REPRESENTED PRUDENT COSTS.	20
B. FCC PROXY OR HATFIELD TELRIC PRICES ARE INAPPROPRIATE ...	23
C. ACCESS PRICES SHOULD BE APPLIED TO UNBUNDLED NETWORK ELEMENTS	27
D. THE OPPORTUNITY TO RECOVER ACTUAL INTERSTATE BOOKED COSTS IS PROTECTED BY LEGAL PRECEDENT.	29
E. THE PROSPECT OF A PRICE SQUEEZE IS UNREALISTIC.	32
F. DEPRECIATION RESERVE DEFICIENCY RECOVERY ISSUES MUST BE SOLVED IMMEDIATELY.	34
G. SWBT’S PUBLIC POLICY RATE ELEMENTS ARE NOT A “MAKE WHOLE” DEVICE.	35

IV.	OTHER ISSUES	36
A.	THERE IS NO BASIS TO INCREASE THE X-FACTOR IN THIS PROCEEDING.	36
B.	THE EXPIRATION OF EQUAL ACCESS AMORTIZATION PROVIDES NO REASON TO REDUCE RATES.	41
C.	THE RECORD DOES NOT SUPPORT ROR REINITIALIZATION.	43
D.	REGULATION OF TERMINATING LOCAL SWITCHING IS UNNECESSARY.	45
E.	JURISDICTIONAL SEPARATIONS ISSUES MUST NOT BE IGNORED IN THIS PROCEEDING.	47
V.	CONCLUSION	48

Summary*

The Comments filed in this docket fall into a number of predictable groups. As the Commission reviews them, it should note that many parties wish to deny the realities of the access reform process. Throughout all the requests and proposals for rate reductions and rebalancing, only a few parties, like SWBT, have proposed plans that properly weigh past Commission precedent and the law against the need to reduce access rates. While other suggested changes to the access charge structure may, at first, appear to have merit when viewed in isolation, the Commission must not lose perspective of all aspects of access charge reform as it considers these changes.

SWBT notes herein that the proper approach is to combine certain portions of both the prescriptive and market-based models to achieve access reform. Importantly, cost causative principles must be employed. Increases to the SLC and the establishment of new rate elements are warranted. Restructuring of certain other existing elements is necessary; for other elements, restructuring should be permissive. Immediate forbearance from price regulation of certain services, and a reasonable procedure to eliminate price regulation from other access services, are also needed.

There is much for the Commission to reject in some of the Comments. The Hatfield Model, closely relied upon by a few of the parties, is shown herein to be fatally flawed, and should not be used as any basis to reduce access charges. Assertions that some investments should now, at this late date, be considered imprudent, do not consider the reasons those investments were made. One party erroneously claims that confiscation does not occur unless the ILECs are forced into bankruptcy. Such arguments should be given no weight in the Commission's deliberations.

*The abbreviations and acronyms used in this Summary are defined in the body of these Comments and have the same meanings as used therein.

SWBT also addresses herein the unreasonable requests to raise the X-factor, to reopen the equal access amortization proceedings, and to reinitialize price caps based on a represcription of the rate of return. These and other arguments should not be used by the Commission to skew application of a proper, comprehensive approach to access reform.

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REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company ("SWBT") hereby replies to the Comments filed by over 100 parties in response to the Commission's Notice of Proposed Rulemaking ("NPRM"), released on December 24, 1996. Approximately 5000 pages of Comments were filed in response to the NPRM's¹ numerous questions and tentative conclusions, but placed in perspective, this record supports the basis for SWBT's plan to respond to the Commission's issues.

SWBT concurs with virtually all commenting parties that access prices must be reduced. However, only SWBT's plan effectively paves the way to an efficiently competitive access rate structure with the proper sequence of action. SWBT's plan² accomplishes the following: it reduces access rates by removing implicit support and establishes explicit recovery mechanisms, it matches recovery with the manner in which costs are incurred, and it leads to ultimate customer gains. In short, SWBT's plan requests that the Commission: 1) Eliminate the per-minute interstate carrier

¹The document released by the Commission included a Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry ("NOI"). The NOI, CC Docket No. 96-263, has a separate comment cycle and is not addressed in this filing.

²SWBT detailed its plan in Comments, Section II. pp. 5-20.

common line ("CCL") by increasing the Subscriber Line Charge (SLC) over two years ; 2) Move non-traffic sensitive ("NTS") line port costs to an end user port charge; 3) Eliminate the transport interconnection charge ("TIC") by restructuring misallocated costs to other rate elements; 4) Establish public policy rate elements to explicitly recover actual costs that could not be rebalanced due to public policy considerations; 5) Seek immediate forbearance from price regulation for competitive access services; and 6) Establish market triggers and attendant pricing flexibilities for all remaining access services.

I. THERE IS NO "FREE LUNCH" IN ACCESS REFORM.

While it was long overdue *before* passage of the 1996 Act, access reform became essential *after* passage of the 1996 Act.³ The implicit support inherent in access charges and deliberate regulatory policy decisions have produced inefficient access rates and a rate structure vulnerable to inefficient competitive entry and pricing arbitrage.

Many competitive LECs ("CLECs") call for regulation of incumbent LEC⁴ access rates to continue for some time into the future. Of course, competitors of incumbent LECs will not be constrained by regulation, and are already able to price and structure their services freely. This asymmetrical regulatory system must be brought to a rapid end. SWBT's plan, as described in its Comments, explains how that can be legally accomplished.

³Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. §§ 151 *et seq* ("1996 Act").

⁴In these Reply Comments, for brevity and unless otherwise noted, the terms "incumbent LEC" and "LEEC" will be used synonymously to refer to incumbent LECs subject to price cap regulation. The term "LEC" will refer to any local exchange carrier.

A. MANY PARTIES HAVE FALLEN INTO PREDICTABLE POSITIONS.

Interexchange carriers ("IXCs") believe that access prices should be reduced to total element long run incremental cost ("TELRIC") or total service LRIC ("TSLRIC"), the TIC should be eliminated and access reform should proceed along a prescriptive path that affords LECs greatly reduced revenues, without pricing flexibility.⁵ IXCs also attempt to use access reform to significantly delay LEC entry into interexchange markets.

Internet service providers argue that they cannot absorb the true cost of their access⁶ and believe that access charges will retard a still developing industry.⁷ This group wants to retain the subsidized below-cost "lunch discount" they have used for years and they think it is "all-you-can-eat."

Large business customers generally favor a market-based approach and support pricing flexibility and cost-based rate restructuring.⁸ Some competitive access providers ("CAPs") acknowledge the need for access reform as well, but believe that reducing access rates may be anti-competitive and may make it impossible for them to enter into the "access" business.⁹

State regulators and certain consumer advocates apparently have a goal to ensure that no customer prices go up regardless of the "true" cost to provide service. As such, they prefer the prescriptive approach.¹⁰ In addition, they oppose SLC increases¹¹ and some go so far as to advocate complete elimination of subscriber line charges.¹²

⁵ AT&T estimates that LEC access prices should be reduced by \$10.6B (AT&T, p. 13). MCI believes LEC access prices should be reduced by \$11.6B (MCI, p. 22).

⁶ America Online, pp. 6-7.

⁷ Microsoft, p. 4.

⁸ For example, GSA supports geographic deaveraging, volume and term discounts, and contract tariffs. They believe request for proposal ("RFP") offerings should exist now. GSA, pp. 22-24.

⁹ ALTS, p.22.

¹⁰ Florida PSC, p. 3.

¹¹ Ohio Consumer Counsel, p. 8, Ohio PUC, p. 3, Texas PUC, p. 4.

¹² Texas OPC, p. 11; State Consumer Advocates (SCA), p. 24.

Of course, none of these parties can realistically argue that the process of bringing increased competition into the access markets will come at no cost. Incumbent LECs must have an opportunity to be compensated for the actual costs that they incur to construct, operate and maintain their networks that comply with current and past service obligations under regulation. Indeed, Chairman Hundt has recognized that there is a strong argument to be made for compensating the ILECs.¹³ Thus, the focus of the issue must be on how to recover actual costs, not whether the cost should be paid.

B. COMPETITIVE MARKETS OPERATE UNDER CERTAIN PRINCIPLES.

The Commission has one ultimate objective: to foster a truly competitive market for access services. SWBT's plan is a clear means for realizing this objective. It accommodates the following fundamental principles which characterize competitive markets. First, implicit support in service rates will not survive. Competitively priced alternatives quickly erode implicit support. Implicit support must be removed before prices will reflect true cost causation. A transition to competitive pricing will cause some existing prices to decrease while other existing prices will increase. Ultimately, consumers benefit from lower prices, greater choice, optimal production and enhanced quality. At some point, if a market becomes a burden on a firm, the firm must decide and be permitted to exit that market.

Second, prices recover underlying costs with no predictable margin levels implied. Markups (i.e., the contribution above incremental cost contained in a product's price) in competitive markets are not automatically "small." Common competitive products often reflect markups in the range of

¹³Speech of Chairman Reed Hundt before the Competition Policy Institute, January 14, 1997. ("It is plain to the FCC and has repeatedly been announced by us that at least hypothetically, a valid argument for recovery of historic or embedded cost that can be made by an ILEC.")

50-300% above what the Commission has called "economic cost."¹⁴ Ultimately, the demand side of the market determines how high or low prices must be. A price is not simply a cost; no formula can predict prices in a competitive market.

Third, price structures reflect how underlying costs are incurred. In order to simulate optimal production, flat fees are used to cover costs that do not vary with demand. Moreover, the party incurring the costs ends up being the party paying, or else severe market distortions would arise.

Fourth, the opportunity to recover actual costs must exist. To maintain long-term viability, actual costs must be recovered. Firms cannot simply price products or services at long run incremental cost levels. This would result in a huge revenue shortfall that could well cause return on investment to become negative. In industries with unit costs that decline when output increases, pricing at incremental cost levels would guarantee that the firm would always operate at a loss. Price set equal to incremental cost is not just a one-time pricing mistake; it is an abrupt spiral into financial ruin.¹⁵

II. SWBT'S PLAN FOR ACCESS CHARGE REFORM FITS THE BILL.¹⁶

Neither the "market-based" approach nor the "prescriptive" approach as described in the NPRM¹⁷ recognize the urgency of access reform or provide incumbent LECs with sufficient flexibility to compete with carriers that will be able to utilize Commission-ordered, directly substitutable, unbundled network elements priced on forward-looking incremental cost. SWBT's approach to

¹⁴Alexander Larson, "A Price Is Not a Formula," *Public Utilities Fortnightly*, Sept. 1, 1996, Larson points out examples such as running shoes with markups at four times costs, jeans with a 40% markup and CDS with prices 58% above wholesale cost.

¹⁵While certainly a typographical error, GSA aptly refers to TELRIC as "Total Element Long Run Incremental Cost." GSA, p. 16.

¹⁶This section addresses NPRM Sections III.A, B, C, D, E; IV; V; VI; VIII.B.

¹⁷NPRM, ¶140-240.

access restructuring overcomes the pitfall of using just one of the Commission's proposed approaches and still satisfies the 1996 Act's deregulatory and pro-competitive pricing directives.

A. SWBT'S PLAN SETTLES THE DEBATE OVER PRESCRIPTIVE VS. MARKET-BASED.

1. SWBT's Plan Contains Proper Aspects of a Prescriptive Approach.

Several parties maintain that a wholesale, prescriptive reduction of access prices to forward-looking cost levels is the only effective means of reducing access rates.¹⁸ SWBT agrees that current access rate levels are unsustainable in a competitive market. Simply slashing access charges -- however accomplished -- does not make the underlying actual costs disappear. Like any competitive firm, SWBT simply could not survive financially if prescribed rates preclude it from recovering actual access costs of the firm. By removing implicit support and establishing public policy elements where appropriate, SWBT's plan: 1) presents a clear path to align access rates more closely with underlying costs; 2) acknowledges the reality and legitimacy of underlying actual costs; and 3) provides for an adequate means to recover those costs.

ACTA¹⁹ recommends that the Commission reject the market-based approach in favor of a more prescriptive approach toward access reform. ACTA states there is no evidence that ILECs would accept the responsibility placed on them by this approach "to foster the continued development of competition in the telecommunications industry." ACTA's position gets to the heart of radical prescriptive proponents: their objective is not to see a market open to competition, but to see a market that favors individual competitors (new entrants) over others (incumbents). The Commission should dismiss ACTA's criticism and choose to foster true competition, not individual competitors.

¹⁸See ACTA, p. 20; AdHoc, p. 42; AT&T, pp. 18-20; CompTel, pp. 3-10; Competition Policy Institute (CPI), p. 34; Frontier, p. 11-13; National Cable, pp. 19-24; Telco Communications Group, pp. 2-7; TRA, pp. 1-3.

¹⁹ACTA, pp. 17-18.

2. SWBT's Plan Contains Proper Aspects of a Market-Based Approach.

Some parties²⁰ admonish the Commission for taking the unprecedented step of anticipating triggers and subsequent pricing flexibilities in their market-based approach before actual local exchange competition is in place.²¹ Some commentators imply that actual competing networks must be ubiquitous and fully operational before regulatory concessions are even entertained. Facilities-based competition, however, is already widespread and operational. Competing networks for high capacity access services are in place in SWBT's major metro markets. SWBT has collocation cross-connects in all five of its states. This reality alone warrants access pricing flexibility now.

In suggesting ubiquitous competing networks as a requirement for market-based pricing flexibility, competitors are attempting to work the ultimate "Catch 22." Competitors are fully aware that extensions of existing competing networks into non-metro and residential markets will not be as forthcoming since the Commission's Interconnection Order has made service competition through Commission-ordered rebundling and resale possible at FCC Proxy TELRIC prices without any investment risk to the new entrant. Competitors will take advantage of this arbitrary advantage while at the same time arguing that incumbent LECs should not receive flexibility until competing networks are present. The result is a regulatory conundrum.

Service competition made possible by the availability of unbundled network elements represents ample competitive threat and thereby warrants substantial access price flexibilities. The open market conditions created by the 1996 Act will produce competitive results much faster than occurred in the long distance industry. The availability of unlimited capacity to competitors at

²⁰For example, ICG Telecom Group, pp. 3-4, 11; Teleport, pp. 34-39; Time Warner, p. 23.

²¹SWBT notes that allowing pricing flexibilities before "actual" competition is NOT unprecedented. SWBT was permitted to offer volume-term arrangements for special access based on customer requests. In addition, the Missouri PSC in 1996 approved an optional payment plan offering for switched access, which was prepared by SWBT in response to specific IXC requests for flexible switched access offerings.

minimum risk and their ability to package local and long distance will make significant competition a certainty. Severe market share loss in the magnitude suggested by ALTS and Teleport²² must be recognized as a self-serving attempt to competitively disadvantage incumbent LECs faced with significant competition made possible through facilities-based competition, ubiquitous unbundling and interconnection.

B. COSTS SHOULD BE BORNE BY THE COST CAUSER.

If the Commission does not allow ILECs the opportunity to be paid in full for the costs they have incurred and continue to incur, confiscation will occur. The best way to prevent confiscation is to follow SWBT's plan, where each customer pays its fair share.

1. End User Costs Should Not Be Recovered From IXC's.

A substantial number of parties concur that NTS loop and NTS switching costs are properly shifted to end users via primary line SLC increases and port charges.²³ In fact, many of the IXC's, that clearly don't see eye-to-eye with ILECs on various components of access reform, strongly support a SLC increase and an end user port charge.²⁴ As Sprint aptly phrased it, "rate rebalancing should not be considered a dirty word."²⁵ An increase in the SLC lowers access charges and reduces long distance charges to customers, resulting in a net decrease in overall prices to customers on average.

Carrier common line charges represent an implicit support flow from access to local exchange service. In its plan, SWBT recommended the elimination of the CCL by first reducing common line revenues to account for the effect of changes to recovery of Long Term Support ("LTS"), pay

²²ALTS, pp. 1-21 (suggesting an optimal market share of 55% for ILECs); American Petroleum Institute (API), p. 20; Teleport, pp. 34-39 (suggesting long distance as the ideal model, where AT&T lost 30-40% market share before regulatory concessions were allowed).

²³See, e.g., Time Warner, pp. 8-10; US WEST, pp. 54-57.

²⁴AT&T, p. 53; Sprint, pp. 11, 18; WorldCom, pp. 31, 38.

²⁵Sprint, p. 6.

telephone costs, marketing related costs and other separations-related reallocations.²⁶ SWBT then recommended elimination of any remaining interstate CCL by using an interim flat-rated public policy element billed to IXC's on a presubscribed line basis.²⁷ SWBT proposed to eliminate this public policy element charge over a two year period by incrementally increasing the SLC for residence and single-line business lines by \$0.65 each year. In addition, SWBT proposed that the distinction between business and residence SLCs should be eliminated by reducing multiline business SLCs to single-line rate levels. SWBT also recommended the application of a single SLC per common line regardless of technology.

Sprint apparently agrees that increases to the single-line SLC and a modest end user port charge will not harm subscribership, and will, in fact, enhance overall consumer welfare. Sprint's own evidence on consumer spending patterns indicates that end user charge increases (like those SWBT recommends) will not be a financial hardship, even for less advantaged subscribers.²⁸ Either SWBT's or the Joint Board's suggested expansion of the Lifeline program will further ensure these consumer gains.²⁹ Expanding federal Lifeline benefits would offset the impact on low income customers of any of the proposed end user increases thus dispelling critics³⁰ that oppose end user increases for potential adverse impacts on low-income subscribers.

The key to consumer gains from switched access price reductions lies in associated reductions in long distance prices. Significantly, at least one IXC commits to passing through access reductions

²⁶SWBT, p. 7.

²⁷In the event an end-user does not have a presubscribed carrier, this charge will be billed directly to the end-user.

²⁸Sprint, pp. 6-7. This evidence concurs with estimates of consumer gain resulting from end user charge increases and access/long distance reductions that SWBT filed in the Universal Service proceeding. See T. Makarewicz, "Efficient Telecom Pricing: Who Stands to Benefit?," *Public Utilities Fortnightly*, March 15, 1996. Makarewicz's estimates cite consumer welfare gains in the range of \$6-7 billion annually, capturing the net effect of lower long distance offset by higher SLCs and port charges.

²⁹Federal-State Joint Board on Universal Service, Recommended Decision, CC Docket No. 96-45, released November 8, 1996, paras. 357-429.

³⁰Frederick & Warinner (F&W), pp. 2-3; Ohio PUC, p. 3; State Consumer Advocates (SCA), p. 24; Texas OPC, p. 11.

to lower long distance rates,³¹ thereby securing the ultimate consumer benefits which SWBT specified in Comments.³² The Commission is in the position to see that the IXC's follow through on this commitment and should pursue the regulatory mechanisms it feels necessary to secure dollar-for-dollar pass through of access reductions to long distance prices.

Many parties oppose increasing the SLC in spite of the strong support for recovery of total loop costs on a flat rate basis from end users. Cable and Wireless believes no changes should be made to the SLC cap for multi-line business and certain residence customers.³³ NARUC believes that common line costs recovered currently by the CCL should be charged to interexchange carriers on a flat-rate basis.³⁴ Several parties oppose SLC increases using various themes.³⁵ Other, more radical parties believe the current SLC can be eliminated.³⁶ Commentors that oppose increasing the SLC have not demonstrated that increasing the SLC by \$1.30 over a two year period would be unaffordable for the majority of residence and single line business customers. Additionally, there is no evidence on the record in CC Docket No. 96-45 to support the fact that a SLC increase would be unaffordable. If the Commission is concerned about the affordability of SLC increases, then it should adopt a benchmark based on an affordability principle as SWBT recommended in its comments in CC Docket No. 96-45. This approach would make it possible for the Commission to recognize that all companies are not alike regarding end user cost recovery. Permitting LECs to increase the SLC when it is not unaffordable would also help to reduce the size of the high cost universal service fund while providing for a more cost based approach to recovery.

³¹MCI, p. 6.

³²SWBT, p. 38.

³³Cable and Wireless, p. 11.

³⁴NARUC, pp. 10-13.

³⁵Ohio PUC, p. 3, SDPUC p. 3, Texas PUC, p. 4, Ohio Consumer Counsel believes TS recovery is appropriate, p. 7; Wash Ind Tel, pp. 4-5.

³⁶The FCC should recover loop costs assigned to the interstate jurisdiction through a flat-rate charge and eliminate the SLC. OPUC p., 4; Texas OPC believes the SLC can be eliminated through an alternate line of reasoning, p. 17.

Numerous parties commented on proposed suggestions for alternate recovery of CCL through flat-rate charges to IXC's or all access customers.³⁷ These suggestions, however deny the fundamental economic link of common line costs to end users.³⁸ Cost causation principles demand that interstate non-traffic sensitive common line and switched port costs be recovered from end users through flat-rate charges.³⁹ The parties preferring to maintain only limited common line cost recovery via the SLC tacitly choose to ignore the real economic benefits from efficient restructuring through SLC increases.

2. TIC Costs Are Legitimate.

SWBT has identified costs currently recovered by the TIC (which are allocated to interstate by Part 36 and to access by Part 69) that may be more appropriately allocated in other ways.⁴⁰ Additionally, there are other costs recovered by the TIC, which, for public policy reasons, should be recovered with a Public Policy rate element. SWBT's proposed treatment of the TIC consists of replacing the TIC primarily through the following measures.

- Recovering costs related to Signaling System 7 ("SS7"), and analog trunk ports that are currently recovered from the TIC, from new access rate elements.
- Correcting cost misallocations from the separations process that have inappropriately assigned costs to switched transport and in certain cases recovering these costs from public policy rate elements.
- Recovering costs associated with providing transport facilities and services to low volume, primarily rural areas and a significant portion of tandem switching costs from a public policy rate element.

³⁷See e.g., Alaska Telephone Assoc., p. 10; Alltel, pp. 11-12; Alabama PSC, p. 4; Florida PSC, p. 2; F&W, p. 4.

³⁸SWBT Comments, pp. 35-36.

³⁹Parties advocating billing a flat rate CCL to IXC's, but allowing IXC's to pass through the charge to end users (WorldCom, p. 34) by default support SWBT's proposal to increase the SLC. With an IXC pass through, the IXC serves only as the "middle man" passing its costs on to end users.

⁴⁰See SWBT's Comments, p. 9 for a concise summary.

Several parties support the TIC solutions in SWBT's plan. Several parties recommend recovery of SS7 costs through separate rate elements.⁴¹ Likewise, several parties support correcting identifiable cost misallocations that are currently recovered through the TIC and collecting them through alternative means of recovery.⁴² Unfortunately, these recommendations on which there is some agreement in the record do not resolve the entire TIC amount. Numerous LECs, who bear the responsibility of providing transport facilities and services throughout the areas they serve, support the recovery of remaining costs (after proposed TIC adjustments) from public policy elements or through other bulk billing mechanisms.⁴³ Certain IXCs and selected others support phasing out or eliminating any remaining portions of the TIC, after adjustments, or elimination of the entire TIC.⁴⁴

Many parties ignore the facts presented in the record by SWBT and others that costs recovered through the TIC are legitimate. AT&T implies that access rates set at TELRIC will allow LECs to recover their transport-related costs and would make the TIC unnecessary. AT&T offers no cost support for its allegation. Their motives are simply to obtain access to the network at lower prices and to gain competitive advantages. The fact that access prices may not recover actual costs associated with providing transport services is apparently not their concern. AT&T and MCI attempt to use the hypothetical costs generated by the Hatfield Model to "assume" away actual costs. Additional information regarding the lack of validity of the Hatfield Model is discussed further in Section III. B. following.

⁴¹Ameritech, pp. 20-28; Citizens p. 31; Sprint p. 28; Time Warner p. 16; USTA p. 61.

⁴²ACTA, p. 14; APSC, p. 11; NECA, pp. 4-5; Pacific Bell, pp. 71-72; SCA, pp. 36-37; TCG, p. 32; Western Alliance, pp. 21-22; USTA pp. 60-66.

⁴³BellSouth, pp. 74-81; Cincinnati Bell, pp. 11-12; NECA, pp. 4-5; Pacific Bell, pp. 71-72; NYNEX/Bell Atlantic, p. 38; SNET, pp. 39-40; TDS, p. 4; U S WEST, pp. 61-70.

⁴⁴ACC, pp. 11-12; AT&T, p. 8; MCI, pp. 84-86; ACTA, p. 14; Ad Hoc, p. 43; CPI, p. 20; EXCEL, pp. 13-14; LCI, pp. 26-28; National Cable, p. 27; Ohio PUC, p. 5; Sprint, p. 28; Telco Communications Group, p. 5; Time Warner, pp. 12-15; TRA, p. 36.

The TIC recovers actual costs allocated to interstate access services through the Part 36 and 69 rules.⁴⁵ ILECs will continue to incur substantial costs to provide ubiquitous transport services in the future. A significant portion of costs associated with serving low volume, primarily rural areas, are currently recovered by the TIC, and would be recovered under SWBT's plan through public policy rate elements. SWBT's proposals will protect the public interest by allowing LECs to recover the costs of providing transport services throughout their serving areas at reasonable rates.

3. Switching Costs

CompTel and Cable and Wireless both support bifurcation of existing switching charges into usage and flat-rate line and trunk port charges.⁴⁶ SWBT supports these changes because they are cost causative and market based. However, these firms and others fall short of recognizing all of the changes that should be allowed in the switching rate structure (e.g., cost causative call set-up).

The Commission recognizes there are distinct costs associated with call set-up. Cable and Wireless claims that call set-up costs are negligible.⁴⁷ AdHoc claims that call set-up charges would be devastating for some, but provides no credible support to back up its claim.⁴⁸ CompuServe and Prodigy merely claim call set-up charges should not be permitted.⁴⁹ This rhetoric does not dispute the fact that certain switching costs are attributed to setting up a call and these costs are traffic sensitive.⁵⁰ Setting up ten one-minute calls would cause more cost than setting up and sustaining a single ten-minute call. ILECs need the flexibility to recover these costs on a flat rate per call basis in order to reflect this cost causation.

⁴⁵See SWBT Comments, Appendix 1 and SWBT Comments in CC Docket No. 91-213.

⁴⁶CompTel, pp. 30-31; Cable and Wireless, (C&W) pp. 12-14.

⁴⁷Cable and Wireless, pp. 12-14.

⁴⁸AdHoc, p. 5.

⁴⁹CompuServe and Prodigy, pp. 25-29.

⁵⁰These costs include processor real time to originate and terminate calls, investment per trunk CCS, signaling (SS7/MF), and AMA (recording and measurement).

WorldCom proposes to eliminate the information surcharge on the basis that the charge recovers the costs of white pages directory production and, as such, should be recovered from end users.⁵¹ The information surcharge recovers the costs of producing white pages directories as well as costs to provide directory assistance to long distance providers. SWBT agrees with WorldCom that costs for white pages directory production should be recovered from end users and the costs for directory assistance should be recovered on a usage sensitive basis.

4. Transport Costs

C&W and Sprint advocate a unified tandem switched transport structure alleging that ILECs could gain more revenues by placing tandems at suboptimal locations in order to increase the mileage portion of the transport rate.⁵² Even if this argument were credible, IXC's could avoid excess mileage by proliferating points of presence ("POPs") or by collocating at tandem offices and self-provisioning transport or obtaining transport from an alternative transport provider. The simple fact is that those parties advocating a unitary structure are aware that the circuits between the POP and tandem are dedicated for their use.

CompTel⁵³ correctly described a dedicated circuit as one that is given a consistent time assignment on an interoffice facility. This is exactly what happens for "bits" transmitted between the SWC and tandem. Each dedicated trunk is given a consistent time assignment between the SWC and tandem. Sharing of time assignments only takes place between the tandem and end office.

The minute-of-use (MOU) rate structure inappropriately forces LECs to provision trunks and facilities "dedicated" to IXC's with little assurance that sufficient traffic will be carried to recover the

⁵¹WorldCom, p. 46.

⁵²Cable and Wireless, p. 15; Sprint, pp. 21-26.

⁵³CompTel, p. 25.

cost of the facilities. As such, the appropriate cost causative rate structure for POP to tandem circuits is a flat-rated charge.

Sprint acknowledges that under the current rate structure, the trunks between the SWC and tandem are somewhat considered "free goods" which may provide the IXC an incentive to order more trunks to the tandem than necessary to accommodate its traffic.⁵⁴ They suggest that the ILEC could establish a "grade of service" standard that would prevent this phenomenon by controlling the traffic. SWBT cannot "control" the traffic on dedicated facilities ordered by customers. SWBT's plan would allow recovery of the dedicated transport between the SWC and tandem from the cost causer via flat rate charges.

Finally, the Telco Communications Group claims that the Commission should implement a transport structure that allocates a portion of tandem switching costs to dedicated transport rates in recognition that common transport facilities are often sized to handle overflow traffic from carriers that use dedicated transport.⁵⁵ This idea should be rejected. Dedicated trunk transport customers that utilize trunking designed to alternately route to a tandem trunk group already pay for use of the tandem switch on a minute-of-use basis during overflow situations. Thus, these carriers are already paying for tandem switching. It would be inappropriate to double charge these carriers for use of tandem switching and would encourage bypass of direct trunked transports.

5. ISPs Must Pay The Costs They Cause.

SWBT has proposed to eliminate the existing enhanced service provider exemption and replace it with a modified access charge structure.⁵⁶

⁵⁴Sprint pp. 25-26.

⁵⁵Telco Communications Group, p. 6

⁵⁶SWBT, pp. 19-20.

SWBT agrees with America On-Line (AOL)⁵⁷ that the Commission should move in the direction of cost-causative rates, and should provide the proper pricing signals for business decisions. SWBT's modified access charge structure proposal satisfies both of these objectives. SWBT's plan should correct any significant inefficiencies in the access structure. SWBT's proposed structure would send the proper pricing signals to information service providers ("ISPs"). It is certainly more cost causative, efficient and appropriate than the flat rated local exchange services which ISPs are currently permitted to use.

One of the most troublesome suggestions made by ISPs in this proceeding is the contention by AOL⁵⁸ that ISP profit margins are thin and assessment of access charges would jeopardize their ability to stay in business. While SWBT certainly is sensitive to the business conditions of ISPs, the implication by AOL that its profit margins should be based on and ensured by contributions from telecommunications customers who do not use ISP services can no longer be justified.

The allegation by CompuServe and Prodigy⁵⁹ that any public switched telephone network ("PSTN") congestion problems are likely attributable to inadequate planning and inefficient engineering by the Regional Bell Operating Companies ("RBOCs") is entirely untrue. Unlike the ISPs who can continually sign up subscribers to service without any requirements to ensure that the ISP has made adequate facilities available to provide service,⁶⁰ SWBT designs its network to ensure that adequate switching and trunking is provided to ensure adequate service levels for all telephone subscribers and satisfies service quality standards required by regulators. It is precisely through this

⁵⁷AOL, pp. 3 & 10.

⁵⁸AOL, pp. 6-7.

⁵⁹CompuServe and Prodigy, p. 14.

⁶⁰AOL recently entered into agreement with numerous state attorneys general to change its marketing practices.

network planning and continuous monitoring and load balancing that SWBT has avoided serious network problems.⁶¹

The contention made by Commercial Internet Exchange Association (CIEA)⁶² that Internet technology is incompatible with payment of per MOU voice telephony access charges misrepresents the issue altogether. SWBT agrees that the use of the Internet and other data type applications are better suited to packet, frame and cell relay type data networks which may be priced on other than per-MOU charge basis. In fact, SWBT has developed and is deploying a new service based on these technologies which offers ISPs the potential for the faster, higher quality and more efficient access capabilities that they indicate is desirable. It also offers the potential to mitigate the network congestion problems created by ISP use of the circuit switched network. However, so long as ISPs use the circuit switched network for access and subsequent connection to the Internet, MOU can be measured and switched access charges are applicable.

C. SWBT'S PLAN PROVIDES PROPER ACCESS CHARGE PRICING FLEXIBILITY.

Commentors propose that ILECs should only be granted additional pricing flexibility if they meet various and arbitrary criteria. AT&T, MCI, API, and TimeWarner⁶³ claim that the Commission should only rely on actual facilities-based competition before granting relaxed regulation. These parties intentionally miss the point. The reality is that access competition is here today. As SWBT has reported before and updates here, SWBT has suffered significant losses in hicap markets in major metropolitan serving areas. SWBT has already lost 43% of the high capacity market in Dallas, 38%

⁶¹In SWBT's experience, ISPs' trunking orders do not necessarily match their marketing plans, causing blocking and network congestion. Further, many ISP customers that grow frustrated with the ISP's lack of facilities have been known to leave their connection up (once established) for extended periods of time so as to avoid the possibility of not being able to establish a connection later. This practice adds to service difficulties.

⁶²CIEA, pp. 9-11.

⁶³AT&T, p. 46; MCI, p. 67; American Petroleum Institute (API), p. 16; Time Warner, p. 26.

in Houston and 15% in St. Louis.⁶⁴ SWBT also has collocation cross-connects in every state with over 10,000 DS1 equivalent cross-connects in the state of Texas alone. Actual facilities-based competition is here today -- widespread and operational -- without even considering the use of unbundled network elements. Attachment CITYDATA is a listing of alternate providers and the cities they serve.

In addition to facilities-based competition, the availability of unbundled network elements (UNEs) represents a sufficient additional competitive threat that warrants substantial access pricing flexibilities. In addition to the facilities of alternate providers, UNEs make additional alternate supply available to all access customers. This supply makes critical the need for access pricing flexibility.⁶⁵

If FCC proxy rates for UNEs prevail and access charges are not collected, SWBT agrees with Sprint⁶⁶ that IXCs can achieve enormous savings through rebundling. The Commission has recognized that UNEs are directly substitutable for ILEC services and that the transport and termination of a local call is physically identical (therefore easily arbitrated) with terminating switched access. The arguments against pricing flexibility for the ILECs are simply those of competitors trying to protect their markets via regulatory fiat. The CAPs are opposed to ILEC pricing flexibility because the current pricing umbrella offered by ILEC tariffed prices allows them significant room to maximize their prices.

Certain services are already experiencing competitive levels sufficient to justify forbearance from tariff regulation.⁶⁷ Competition for these services oppose such relief.

⁶⁴Quality Strategies, November 96 Report, Copyright 1995, 1996.

⁶⁵APT, pp. 6-7. APT observes that the Commission should be more concerned with predatory low pricing for access rather than excessive charges for access or interconnection.

⁶⁶Sprint, p. 33.

⁶⁷The following services are already subject to the level of competition specified in Section 10(a) necessary to justify their removal from tariff regulation: Special access; Dedicated transport to end offices and tandems; Directory assistance and operator services; and Interexchange services. Carriers should be allowed to continue to file tariffs for interexchange services as advocated in SBC's Comments filed January 28, 1997, on AT&T's Petition for Reconsideration in CC Docket No. 96-61.

III. ACCESS STRUCTURE MUST PROVIDE THE OPPORTUNITY FOR INCUMBENT ILECS TO RECOVER ACTUAL INTERSTATE COSTS.⁶⁸

The Commission moved the fundamental policy decision regarding recovery of actual costs from the Interconnection proceeding into the Universal Service and/or Access Reform proceedings.⁶⁹ Subsequently, the Joint Board Recommended Decision in the Universal Service proceeding recommended moving the responsibility for that decision (at least common line cost recovery) into the Access Reform proceeding.⁷⁰ Whether the Commission adopts the Joint Board Recommendation on this point remains to be seen. Regardless, the Commission still faces the decision of whether to adopt any specific public policy cost recovery mechanism(s) in the Access Reform proceeding and it would be unlawfully confiscatory for the Commission to only adopt TELRIC or TSLRIC pricing standards in each of the three legs of the stool without providing the ILECs an opportunity to recover their actual costs.⁷¹

Several parties compute differences between the ILECs' actual costs and the hypothetical costs of an efficient forward-looking network and then draw unwarranted conclusions based on the existence of a difference. These parties typically claim that, because a difference between the two types of cost exists, one of two types of costs is fundamentally wrong and the existing rate recovery

⁶⁸This Section addresses NPRM Sections II.B; III.E; VII.A, B.

⁶⁹During oral argument in the appeal of the Interconnection Order, FCC counsel stated that:

There's absolutely no reason why as part of that [universal service process] a competitively neutral fund that everyone pays can't be collected and used to reimburse any stranded or embedded costs that exist. The access charge proceeding, the same possibility is there.

Iowa Utilities Board v FCC, Cause No. 96-3321, Transcript of Oral Arguments of Counsel, January 17, 1997.

⁷⁰Federal-State Joint Board on Universal Service, Recommended Decision, CC Docket No. 96-45, released November 8, 1996, para. 771.

⁷¹At least one party suggests that "consistency" requires that the same set of costing and pricing decisions be used in all "three legs of the stool." See, e.g., MCI, pp. 1-3. SWBT vehemently disagrees. If the costing and pricing decision adopted by the Commission in one or two of the legs of the stool deny the ILECs rate recovery of actual costs for specific policy reasons, it would be "inconsistent" and unlawful not to recognize that fact and address recovery of actual costs in one of the other legs of the stool.

available to the ILECs must be reduced.⁷² An important task in this proceeding is to discern whether and why this overly simplistic view is wrong.⁷³

Surely, there is more than one or two ways to view costs. The bare assertion, however, that the actual costs incurred by the ILECs are not equal to the TELRIC or TSLRIC estimates prepared by certain parties is not, and cannot be, lawfully sustained as a reason for reducing ILECs' rate recovery. In the long run, if a firm cannot cover its actual total costs, it will not survive. Other claims that ILEC actual costs should not be recovered are equally bare, and should be rejected, as detailed below.

A. REGULATORS HAVE PREVIOUSLY DETERMINED THAT THE INCUMBENT LECs' ACTUAL COSTS REPRESENTED PRUDENT COSTS.

SWBT's plan recognizes that neither regulators nor any specific cost/pricing models can entirely substitute for the intelligence of the market and allows the ILECs a reasonable opportunity to recover their actual costs.⁷⁴

Some parties question the efficiency of the ILECs' past investments and expenses based on the fact that actual costs are not equal to forward-looking cost estimates. The relevant question is not whether the current level of ILECs' investments are efficient only from a forward-looking

⁷²For example, AARP, Attachment 1, p. 1 states: "It is quite clear that substantial differences exist." . . . "This means the artificially high rates being charged today are unwarranted."

⁷³The AARP includes an attachment that presents its views regarding the proper pricing of basic residential local exchange service. This attachment contains many conceptual errors, and the vast majority of its discussion focuses on the pricing of basic residence local service and has no relevance to the cost recovery and access pricing issues in this proceeding.

⁷⁴"Those commentators [AT&T, MCI, WorldCom, Florida PSC and Ad Hoc] ignore the adverse economic consequences for consumers and incumbent LECs that would result from the Commission's imposition of TELRIC pricing for interstate access if such pricing were not accompanied by a competitively neutral and nonbypassable charge sufficient to meet the incumbent LEC's shortfall in its ability to recover its full economic cost of providing service." USTA Reply Comments, Attachment, Sidak and Spulber, (Sidak/Spulber Reply) p. 3.